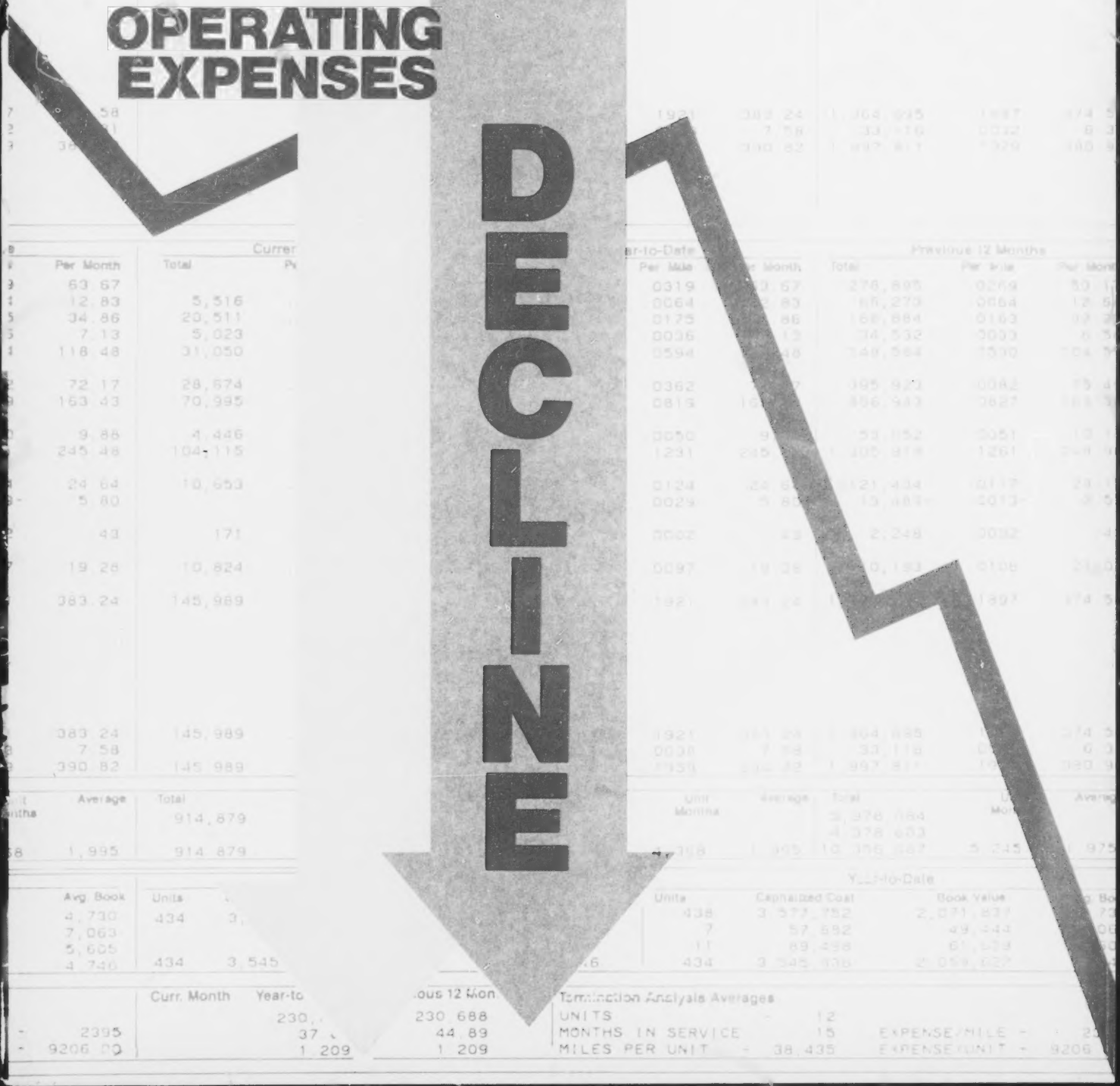
NAFA
Bulletin
The Magazine for Fleet Administrators
April 1984

OPERATING EXPENSES DECLINE



Official Monthly Publication of
The National Association of Fleet Administrators, Inc.
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NAFA Bulletin

The Magazine for Fleet Administrators
April 1984

Cover illustrated by Cindi Samol

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1983 NAFA Survey Results:

Fleet Operating Costs Fall Below 8¢ a Mile

NAFA Exclusive

Fleet operating expenses in 1983 declined for the second year in a row after 10 consecutive years of increases, according to the annual operating expense survey conducted by the National Association of Fleet Administrators, Inc.

A total of 85 fleets, operating more than 75,000 passenger cars, submitted data for the annual survey.

Operating expenses declined about two-thirds of a cent per mile in the "composite" fleet (those fleets that do not break out expenses by the size of car). Operating expenses declined about a penny per mile for compact cars, and approximately half a cent a mile for mid-size cars.

Using a figure of $1.235 for an average price of a gallon of fuel (the Runzheimer estimate which is exactly half-way between the estimates used by two large fleet management companies), average miles per gallon for compacts was 24.1; for mid-size cars the average miles per gallon was 20.05, and for the composite fleet it was 21.3.

NAFA Car Size Categories

Sub-Compact Cars: Wheelbase of less than 99 inches and a curb weight of under 2,199 pounds.

Compact Cars: Wheelbase between 100 and 104 inches and a curb weight of between 2,200 and 2,599 pounds.

Mid-Size Cars: Wheelbase between 105 and 108 inches and a curb weight of between 2,600 and 3,199 pounds.

Large Cars: Wheelbase of more than 108 inches and a curb weight of more than 3,200 pounds.

The results of the survey are based on NAFA's Recommended Classification of Automobile Expenses (see page 10). Under this accounting system, fleet costs are divided into three major categories:

Operating Expenses: These costs consist of all expenses directly related to running a vehicle — fuel, oil, tires and tire repair, and normal maintenance and repair. These expenses are computed in pennies per mile per car.

Incidental Expenses: These costs consist of licenses and taxes, accident repairs less recoveries, washing, parking and tolls, and miscellaneous expenses. These costs are computed on a dollars per car per month basis.

Standing Expenses: The final category consists of investment costs, either interest paid on purchases or leasing company service charges, depreciation reserve, insurance, and selling costs. Deducted from these expenses are depreciation adjustments (if any) after a vehicle is sold. The standing expenses are also expressed in dollars per car per month.

Subtracted from the incidental and standing expenses are chargebacks or credits for personal use and optional equipment acquired by the company car operator.

Composite Fleet

The largest segment of the survey response fell into the composite fleet group that consists of those fleets reporting total expenses without breaking out those expenses by car size grouping.

The actual make-up of the composite fleet in the 1983 survey is, two percent sub-compacts, 72 percent compacts, 24 percent mid-size, and two percent large cars. Seventy-eight percent of the cars in the group have four-cylinder engines; 20 percent have six-cylinder engines, and two percent have eight-cylinder power plants.

The fleets in this group provide well equipped cars for their operators. Ninety-nine percent are air conditioned, 97 percent have automatic trans-

mission, and 100 percent have both power steering and power brakes.

The vehicles in the composite group were kept in service an average of 31.4 months and driven an average of 55,575 miles before being replaced.

Total operating expenses in 1983 amounted to .0793 cents per mile, down from .0861 in 1982. Operating expenses have declined more than a penny and half a mile from the 1981 operating survey results, primarily because of lower fuel costs (estimated at $1.235 during 1983) compared to $1.36 in 1982. Fuel economy for the group showed a slight increase in 1983, up from 21.1 in 1982 to 21.3 miles per gallon in 1983.

Tire expenses also continued to decline among the fleets in this group, while repairs and maintenance, as well as oil, showed slight increases over the past two years.

Incidental expenses showed a slight decline of less than 50 cents per car per month in 1983, primarily because of lower expenses reported for washing and parking and tolls. License and taxes, as well as accident repairs, increased in 1983.

"Lower fuel costs, improved economy are major factors in overall decline in fleet operating expenses for all car size categories."

For the first time in recent years, standing expenses showed a slight decline in 1983. Both service charges and depreciation reserves were less than in 1982, while the depreciation adjustment also dropped during the year.

Personal use chargebacks continued to increase, going up more than five dollars a month in 1983. Combined incidental and standing expenses were $228.77 in 1983, $16 a month less than in 1982, and two dollars below the 1981 figure.

Translating the total expenses into dollars gives a figure of $373.18 per month. Expressed in pennies per mile, the total cost is 20.5 cents a mile, exactly what the IRS allows for the first 15,000 miles when a driver deducts automobile expenses on an income tax return.

Mid-Size Cars

Total operating expenses for mid-size cars (vehicles with a wheelbase of between 105 and 108 inches and a curb weight of between 2,600 and 3,199 pounds) amounted to .0865 cents per mile in 1983. This is about half a cent less than the .0920 cents per mile reported in 1982.

The cost of fuel declined more than a penny per mile, but much of this saving was offset by a major increase in repair and maintenance costs (up to .0169 a mile in 1983, compared to .0105 in 1982).

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Operating Expense Comparisons Composite Fleets 1981 - 1983

	1981	1982	1983
Average Miles per Month	1,822	1,880	1,821
OPERATING EXPENSES			
(cents cost per car per mile)			
Fuel	.0745	.0643	.0579
Oil	.0012	.0011	.0016
Tires & Tire Repair	.0059	.0057	.0041
Repair & Maintenance	.0142	.0150	.0157
Total Operating Expenses	.0958	.0861	.0793
INCIDENTAL EXPENSES			
(dollar cost per car per month)			
License & Taxes	$ 6.23	$ 8.63	$ 9.95
Accident Repairs — Recoveries	8.65	7.39	8.85
Washing	5.04	6.14	4.12
Parking & Tolls	16.48	12.09	11.06
Miscellaneous	3.29	2.98	2.97
Total Incidental Expenses	$ 39.69	$ 37.23	$ 36.95
STANDING EXPENSES			
(dollar cost per car per month)			
Leasing Service Charge or Interest	$ 74.86	$ 76.38	$ 72.05
Depreciation Reserve	154.89	161.37	153.65
Depreciation Adjustment	-17.56	-23.06	-12.38
Selling Expenses	1.35	11.38	5.04
Insurance	21.27	23.94	20.96
Total Standing Expenses	$234.81	$250.01	$239.32
CREDITS			
(Dollar return per car per month)			
Personal Use Credit	$ 41.48	$ 42.28	$ 47.70
NET EXPENSES			
(Incidental expenses plus standing expenses less credits)	$230.87	$244.96	$228.77

NAFA's Recommended Classification of Automobile Expenses

OPERATING EXPENSES (expressed in cents cost per mile)

1. *Fuel.* Include additives, if allowed.
2. *Oil.* Include engine oil, oil additives, if allowed and oil changes. Do not include lubrication or filters.
3. *Tires.* Include purchase of replacement tires, snow and studded tires or cost of studding; deduct adjustments on returns. Include repairs, charges for rotation. Do not include balancing or alignment charges.
4. *Maintenance & Repair.* Include all mechanical and electrical repair, excluding repair of accidental damage. Include chassis lubrication, transmission and hydraulic fluids, filters, wheel balancing and alignment, brake adjustments and towing. Include all charges for regular maintenance and tune-ups. Maintenance & Repair is defined as "All actions taken to keep company vehicles operating at peak efficiency with minimum costs for parts and labor and minimum out-of-service time."

STANDING EXPENSES* (expressed in dollar cost per car per month)

Expenses incurred in automobile operation that have little or no direct relationship to the mileage a vehicle is driven. The items in this category sometimes are referred to as "Fixed Expenses" or "Non-Variable" expenses. They often are pre-determined and do not vary during the life of the vehicle. These expenses are best expressed in a dollar cost per car per month.

1. *Investment cost.* Include total capitalized cost of vehicle; deduct charges to employees for optional equipment.
    a. For leased fleets, use monthly rental payment.
    b. For company owned fleets, include interest on money used for purchases.
2. *Depreciation.* Include reserves established at pre-determined rate as well as adjustments after cars are disposed of. If insurance payments for work not performed are included in accident repairs, deduct from adjustments.
3. *Insurance.* Include all amounts actually paid to insurance premiums to provide coverage. Insurance is defined as "The protection purchased against claims of bodily injury or property damage (PD & PL) resulting from accidents; losses resulting from fire, theft, and vandalism. Premiums are usually based on previous experience and losses. Companies can 'self-insure' themselves against collision or medical losses by setting aside a periodic reserve for each car in operation."

INCIDENTAL EXPENSES (expressed in dollar cost per car per month)

Those expenses connected with automobile operation that do not occur on a regular basis, nor are they directly related to mileage or car use. The recommended procedure is to present these expenses in dollars per car per month.

1. *License & Taxes.* Include city and state licenses, Federal, state, and city taxes; personal property, sales, use, and rental taxes; registration and license fees; notary public fees; title and transfer fees; inspection fees; permits, and fees for duplicate titles.
2. *Accident Repairs.* Include all labor materials, towing and other expenses resulting from an accident. Deduct payments from insurance companies or others regardless of date of accident; include payments for work not performed.
3. *Washing.* Include all company-paid expense for washing, waxing, and polishing.
4. *Parking & Tolls.* Include all highway, ferry, tunnel, and bridge tolls. Include use of outside parking lots, parking meters, garages, and garage allowances.
5. *Miscellaneous.* Include any items related to the operation of the car not covered elsewhere, such as anti-freeze, flares, seat covers, floor mats, and chains.

* *Administrative expenses, if available, should be included in* **Standing Expense** *category. They would include salaries of fleet department personnel, share of corporate overhead (rent, light, heat, telephone, pro-rate cost of accounting, legal, finance departments, and other services needed for fleet operation).*

Operating Expense Survey

(Continued from page 9)

The average miles per gallon consumption of mid-size cars continued to increase in 1983, reaching 20.5, compared to 18.2 in 1982, and 17.3 in 1981.

The cars in the mid-size group were kept in service an average of 26.3 months and driven 58,166 miles before being replaced.

Six percent of the cars in this group were equipped with four-cylinder engines; 82 percent had six-cylinder engines, and 12 percent had V-8 engines.

Every car in the group was equipped with air conditioning, power brakes, and power steering. More than 99 percent also had automatic transmissions.

Compact Cars

Operating expenses for compact cars fell below seven cents a mile for the first time in many years. They were above nine cents a mile in 1981, and just below eight cents a mile in 1982.

Cars in this group (a wheelbase of between 100 and 104 inches and a curb weight between 2,200

(Continued on page 14)

Operating Expense Comparisons
1981 - 1983
Mid-Size Cars

	1981	1982	1983
Average Miles per Month	1,799	2,027	2,236
Fuel	.0781	.0748	.0616
Oil	.0010	.0014	.0016
Tires & Tire Repair	.0064	.0053	.0064
Repair & Maintenance	.0118	.0105	.0169
Total Operating Expenses	.0973	.0920	.0865
Average price per gallon of fuel	$1.35	$1.36	$1.235
Average miles per gallon	17.3	18.2	20.05

Compact Cars

	1981	1982	1983
Average Miles per Month	1,794	2,339	2,153
Fuel	.0725	.0627	.0517
Oil	.0011	.0015	.0017
Tires & Tire Repair	.0052	.0040	.0035
Repair & Maintenance	.0123	.0112	.0126
Total Operating Expenses	.0911	.0794	.0695
Average price per gallon of fuel	$1.35	$1.36	$1.235
Average miles per gallon	18.6	21.8	24.1

Cost-Effective Tire Management

The following article, based on material prepared by Matt Strong of Sumitomo Tire, focuses on cost-effective ways to reduce tire and tire repair expenses.

Fleet managers will be surprised at how much money they can save through proper tire management. The first step to cutting tire costs, though, is not to spend less on tires, but to understand the concept of cost per mile (cpm). To calculate cpm, add the initial price and maintenance costs of your tire, subtract the trade-in value, and then divide by the number of miles you've driven.

Proper tire maintenance is more a matter of watching little things than of handling major problems. Besides repair and retreading, the main areas of concern are tire pressure, rim assembly and total vehicle alignment.

Maintaining correct tire pressures could reduce tire costs by 20 percent. Incorrect pressures often cause major tire problems; low pressures hasten heat generation and tire casing degredation or failure, while high pressures lead to impact damage, spot wearing and vehicle suspension damage. Both can cause irregular wear patterns. It is important to review load/inflation tables and have your fleet's tire pressures checked frequently.

Damaged casings should be fixed immediately. Keep in mind that, due to the risk of oxidation, it's vital to repair steel radial tires right away. Pulling tires for retreading before they reach 4/32" of tread depth will save casings and assure a higher degree of retreadability.

Vehicle Alignment

In terms of vehicle alignment, the first step is to assure that the axles are perfectly perpendicular. Therefore, the tires will be parallel to it. Then measure component-to-component distances and assure that they are equal from side to side. This is especially critical after a wreck or axle/suspension repairs.

Vehicle alignment is actually a category all by itself. Just a quarter inch out of specification can easily reduce tread life 25 percent. The most important thing here is to follow the manufacturer's specifications **to the letter**.

Other Factors that Affect Tire Life

There are many other factors besides vehicle alignment that shorten the life of a tire, including such well-known problems as worn out springs, shock absorbers and bushings, as well as loose chassis and grabbing brakes.

Keep in mind that left front tires wear faster than right front tires by about 15 to 20 percent on a front-wheel drive car. Driving and turning causes excessive wear on the front tires. Remember to install tires in the colder part of the year (fall and winter); you'll increase tread life 12 to 15 percent over installing them during the hotter periods.

Finally, and most importantly, keep records. The best teacher is experience, and once you apply these tips to your fleet's tires you will quickly see how much money you can save.

Operating Expense Survey

(Continued from page 12)

and 2,599 pounds) averaged 24.1 miles per gallon in 1983, an increase of more than two miles a gallon from the 1982 report, and a remarkable increase of almost six miles per gallon since the 1981 survey results were published.

Ninety percent of the cars in the compact group have four-cylinder engines; the remaining 10 percent are powered by six-cylinder engines. Every car in the group is equipped with power steering and power brakes while 99 percent have air conditioning and automatic transmissions.

The cars in the compact group were kept in service an average of 29.1 months and driven 61,746 miles before being replaced.

Canada

Canadian fleets participating in the annual operating expense survey had far higher expenses than United States' fleets. The average for the group was slightly more than 13 cents a mile. The largest portion of this, of course, was for fuel, almost 10 cents a mile. This figure is based on an average cost of 50 cents a liter which translates to approximately $1.90 a gallon.

Fleet expenses in Canada were also higher for oil, tires, and repairs and maintenance; every category of operating expenses.

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COMPOSITE FLEET BREAKDOWN OF EXPENSES

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Fifty-five percent of the Canadian fleet consists of compacts; 42 percent are mid-size cars, and three percent are large cars. One third of the Canadian cars in the survey have four-cylinder engines; 66 percent have six-cylinder engines, and one percent have eight cylinder engines.

Seventy-eight percent of the Canadian cars are air conditioned; 99 percent have automatic transmission; and 100 percent have both power steering and power brakes.

The Canadian cars were kept in service an average of 32 months and driven 49,491 miles before being replaced. ■

Operating Expenses
Canada

Average Miles per Month	1,780
Fuel	.0979
Oil	.0026
Tires & Tire Repair	.0080
Repairs & Maintenance	.0221
Total Expenses	.1306
Average price per gallon of fuel	$1.90
Average miles per gallon	19.4

Highway Loss Data Institute Reports:

1983 Domestic 4-Door Models Had Lowest Collision Loss Experience

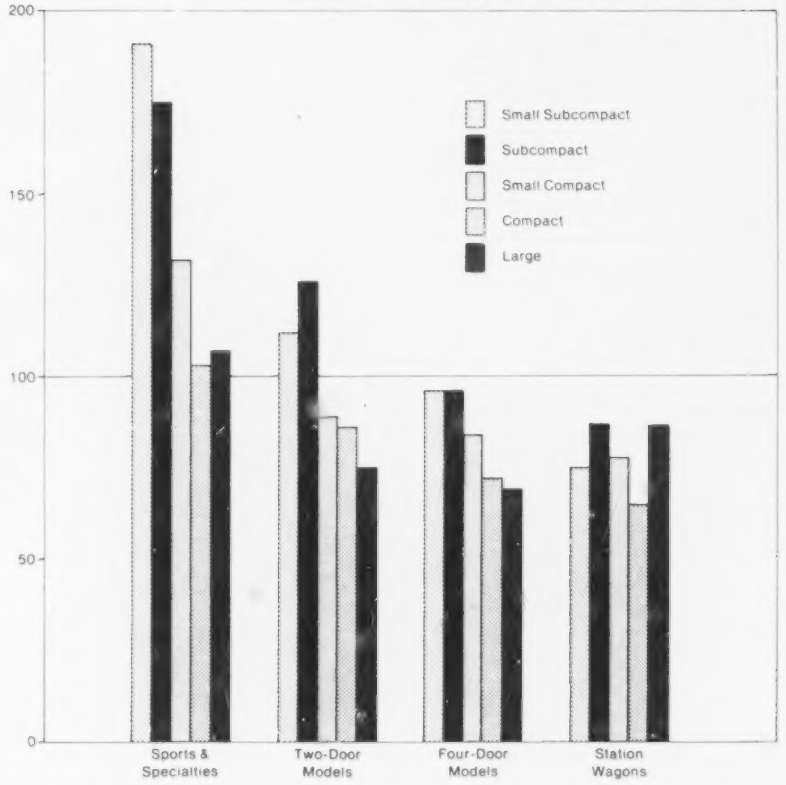
THE HIGHWAY LOSS Data Institute (HLDI) is a nonprofit, public service organization that gathers, processes, and publishes insurance data concerned with human and economic losses associated with motor vehicle use and especially the ways such losses vary among different kinds of vehicles.

The Institute's current report describes the collision coverage loss experience of 1983 models during their first year of availability, 1982 models during their first two years, and 1981 models during their first three years.

This report is based on collision coverage and loss data supplied by eleven insurers: Aetna, Allstate, GEICO, Kemper, Liberty Mutual, Nationwide, Prudential, Safeco, State Farm, Travelers, and USAA.

FIGURE 1

Collision Coverages
Relative Average Loss Payments Per Insured Vehicle Year
1983 Model Year Passenger Cars



The principal findings of the January 1984 report by the Highway Loss Data Institute are:

- Among the high-volume 1983 cars, the four-door Mercury Grand Marquis had the best collision coverage loss experience and the Chevrolet Camaro the worst. Among the low-volume cars, the Datsun 280ZX had the worst results and the American Eagle 30 station wagon the best.
- All eleven 1983 model year cars with the best collision coverage loss experience were either regular four-door models or station wagons and all but one were domestic models.
- The 1983 model year cars with the worst collision coverage loss experience were all either regular two-door models or sports or specialty models and eleven of the twelve were imported models.
- Two-door models consistently had higher collision losses than comparably-sized four-door models and station wagons.
- The two-door models of the Honda Civic and Honda Accord for 1983 were among the cars with the worst collision coverage loss results, in contrast with prior model years in which these cars had consistently better than average results. The poor loss experience for the 1983

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HLDI Report

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Honda models basically results from substantial increases in claim frequencies and slight decreases in the average loss payments.

- Among the vans, pickups, and utility vehicles, small utility vehicles and small pickups had the highest average loss payments per insured vehicle year. Vans and large utility vehicles had the lowest.
- For utility vehicles, the claim frequencies tended to increase slightly with increasing vehicle size, but the average loss payments per claim were much larger for the small utility vehicles. All utility vehicles had better than average claim frequencies, but most of the small and intermediate utility vehicles had average loss payments per claim which were worse than average.

Passenger Cars

The results for the 1983 model passenger cars were based on 780,000 insured vehicle years of exposure, those for the 1982 models on over three million insured vehicle years, and those for the 1981 models on nearly six million insured vehicle years. Generally, the greater the exposure associated with a result, the more confidence can be placed in it.

1983 Models During Their First Year

Table 1 summarizes the 1983 model year passenger cars with the best and worst collision coverage loss experience during their first year of availability. The cars listed were taken from the 157 individual 1983 vehicle series which had more than 1,000 insured vehicle years of exposure. Twenty-two of those series were high-volume cars, each accounting for at least one percent of the total 1983 model year exposure.

Among the high-volume cars, the four-door Mercury Grand Marquis (61) had the best collision coverage loss experience. Among low-volume cars, the American Eagle 30 Station Wagon (55) had the lowest average loss payment per insured vehicle year. Of the eleven series with the best collision coverage loss experience listed in Table 1, eight were regular four-door models and the other three were station wagons. Ten of the eleven were manufactured in the United States.

Half of the cars listed with the worst collision coverage results were sports or specialty models and the other half were small two-door models. All but one of the twelve were imported models.

Figure 1 shows the average loss payments per insured vehicle for 1983 models by car size and body style group — sports and specialty models, regular two-door models, regular four-door models, and station wagons. These results are presented *relative to the result for all 1983 cars combined*, with the value 100 representing the average loss payment per insured vehicle year of $129.

"As in previous years, the cars with the worst collision coverage loss experience were either regular two door models or sports or specialty models."

Figure 1 also shows the sports and specialty models of all sizes and the small two-door models had average loss payments per insured vehicle year which were higher than the average for all 1983 models combined; the small subcompact and subcompact sports models had particularly bad collision coverage loss experience. In addition, **Figure 1** reveals that regular two-door models generally had higher average loss payments per insured vehicle year than regular four-door models and station wagons of the same size.

1982 Models During Their First Two Years

The 1982 model year passenger cars with the best and worst collision coverage loss experience during their first two years of availability were taken from the 211 individual 1982 vehicle series which had more than 1,000 insured vehicle years of exposure.

Among the high-volume cars, the four-door Oldsmobile Delta 88 had the lowest average loss

(Continued on page 24)

TABLE 1

Relative Average Loss Payments Per Insured Vehicle Year for 1983 Model Year Cars With the Best and Worst Collision Coverage Loss Experience*

	Best			Worst		
HIGH VOLUME (At least 1% of total exposure)	Mercury Grand Marquis	4 Dr	61	Chevrolet Camaro	Sp	174
	Buick LeSabre	4 Dr	63	Toyota Celica	2 Dr	132
	Oldsmobile Ciera	4 Dr	63	Toyota Corolla	2 Dr	129
	Ford Escort	S W	70	Nissan Sentra	2 Dr	119
	Chevrolet Caprice	4 Dr	70	Honda Accord	2 Dr	117
				Honda Civic	2 Dr	117
LOW VOLUME (Less than 1% of total exposure)	American Eagle 30	S W	55	Datsun 280ZX	Sp	226
	Chrysler New Yorker	4 Dr	57	Porsche 944 Coupe	Sp	220
	Toyota Tercel 4WD	S W	57	BMW 320i	Sp	217
	Buick Electra	4 Dr	61	Datsun 280ZX 2 + 2	Sp	216
	Ford Crown Victoria (Ford LTD)	4 Dr	64	Mazda RX-7	Sp	183
	Buick Regal	4 Dr	64	Dodge Challenger	2 Dr	183

*100 represents the average for all 1983 cars ($129)

Highway Loss Data Institute

Definitions

Average Loss Payment per Claim — the total of all loss payments made for the claims for a group of vehicles, divided by the number of claims paid; expressed as dollars per claim.

Average Loss Payment per Insured Vehicle Year — For a group of vehicles, the product of Claim Frequency and Average Loss Payment per Claim, divided by 100; expressed as dollars per insured vehicle year. It should be noted that this definition differs from the commonly used insurance term, pure premium, but yields similar results.

Claim Frequency — The number of claims for a group of vehicles, divided by the exposure for that group; expressed as claims per one hundred insured vehicle years.

Collision Coverages — As defined in insurance contracts, the coverage under which people insure their own vehicle against loss caused by collision.

Deductible Amount — That portion of the collision damage cost borne by the policyholder. For computing results, deductible amounts are split into two groups; less than $150 (mainly $50 and $100 deductibles) and greater than or equal to $150 (mainly $200 and $250 deductibles).

Exposure — The time interval an individual vehicle is insured. Exposure for a group of vehicles is expressed in units of insured vehicle years.

Loss Payment — That portion of the collision damage cost borne by the insurer; in general, the total collision damage cost minus the deductible amount.

Operator Age Group — The factor which distinguishes those vehicles whose rated driver is youthful from those vehicles whose rated driver is not youthful (see Youthful Operator).

Rated Driver — the driver who, for insurance purposes, is considered to represent the greatest loss potential for the insured vehicle.

Vehicle Class — There are four vehicle classes, defined as follows:

1. Passenger Cars — There are four major body style groupings of passenger cars — regular two-door models, regular four-door models, station wagons, and sports and specialty models. Sports and specialty models include all two-seater cars, all convertibles, those cars larger than subcompacts which have two-door models only, and all luxury cars. Each body style group is further divided into size class subgroups as follows:

Small Subcompact — Cars with wheelbases less than or equal to 96 inches.

Subcompact — Cars with wheelbases greater than 96 inches and less than or equal to 106 inches.

Compact — Cars with wheelbases greater than 106 inches and less than or equal to 111 inches.

Large — Cars with wheelbases greater than 111 inches.

2. Vans — Fully enclosed vehicles with either no hood or a very short hood, in which the engine is placed at least 50 percent behind the windshield. The driver's position is usually well forward, nearly beside the engine, usually within the for-

(Continued on page 24)

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HLDI Report

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payment per insured vehicle year. All five of the low-volume cars with the best results had average loss payments per insured vehicle year which were slightly more than one-half the result for all 1982 cars combined. Nine of the ten cars with the best collision coverage loss results were either four-door models or station wagons and all ten were manufactured in the United States.

All of the 1982 models with the worst collision coverage loss experience were sports or specialty models or small two-door models, and six of the ten were imported.

1981 Models During Their First Three Years

The 1981 model year passenger cars with the best and worst collision coverage loss experience during their first three years of availability were taken from the 203 individual 1981 vehicle series which had more than 1,000 insured vehicle years of exposure.

As with the 1982 models, all but one of the cars with the best collision coverage results were four-door models or station wagons, and all those with the worst results were sports or specialty models or small two-door models. All of the cars with the best experience were domestics and most of those with the worst results were imports. ■

HLDI Definitions

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ward 25% of the wheelbase. These vehicles are designed for cargo transport and are equipped with a right side cargo access door and rear doors. The cargo area is not separated from the passenger area — both are enclosed under the same roof. Some passenger vans are equipped with additional seats in the cargo area and usually have additional side windows also.

3. Pickups — Cargo-carrying vehicles, usually on a truck chassis, with an enclosed cab and a separate open cargo area. The open cargo area generally is a box with raised sides with an opening tailgate. There are also a small number of auto pickups which are similar to regular pickups except that they are built on a passenger car chassis. Pickups are further divided into two subgroups based on curb width — small pickups (less than 3,000 pounds) and standard pickups (3,000 pounds or more).

4. Utility Vehicles — Vehicles built on a heavy-duty chassis capable of off-road use. They are of conventional construction with the driver behind the engine. The cargo and passenger areas are integral with the driver area. Many of these vehicles are equipped with soft or removable tops. Frequently, these vehicles are equipped with four-wheel drive. Utility vehicles are further divided into three subgroups based on wheelbase — small utility vehicles (less than 100 inches), intermediate utility vehicles (from 100 to 120 inches), and large utility vehicles (greater than 120 inches).

Vehicle Identification Number (VIN) — A code, variously comprising both numbers and letters; normally, 8 to 17 characters in length, assigned to each vehicle by its manufacturer. The VIN uniquely identifies the vehicle within at least a ten-year time span and, in recent model year vehicles, contains coding which identifies the make, series, model year, and other characteristics of each vehicle.

Vehicle Series — A name denoting a family of vehicles, within a make, with the same wheelbase and a degree of commonality in construction such as body, chassis, etc.

Youthful Operator — For the purpose of this report, all males (married or single) under 25 years of age and all unmarried females under 25 years of age. ■

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National Economic Policy:

Leasing Helps Create New Jobs; Stimulates Business Investment

The leasing of capital equipment in the motor vehicle industry has expanded so rapidly in recent years that it now represents one of the most important sources of financing for the acquisition of capital equipment.

According to a report on lease financing by Andrew Brimmer, a former member of the board of the Federal Reserve, many companies which are unable to take advantage of the tax benefits associated with the purchase of new equipment, look to leasing as a means of lowering their cost of capital.

The report, commissioned by the General Electric Credit Corporation (GECC), explains the current strategies behind the growing use of leasing as a financing tool. Leasing companies like GECC can apply incentives, such as accelerated depreciation and investment tax credits, often charging depreciation and investment tax credits, at rates below what the company would pay if purchasing the equipment outright.

The study points out that companies in the motor vehicle industry enjoy the further advantage of improving their cash flow by avoiding the high cost of tying up their cash in equipment purchases. "This money could be put to better uses, such as working capital, research and development, or acquiring short-term financial assets," explained Gary Wendt, vice president of GECC. "What's more, compared with bank loans, leasing typically requires a smaller down payment and fewer restrictions. Plus, many lease arrangements included maintenance and repair services."

The following article, based on an Executive Summary of the Brimmer report, focuses on the economic benefits of lease financing and its impact in the motor vehicle industry.

Traditional guideline leasing constitutes a major source of capital for American industry. This method of financing has helped to expand the availability of funds — and to reduce the cost of credit — to many segments of American business, which would otherwise find it difficult to obtain the equipment and facilities needed for expansion.

These general conclusions are derived from a comprehensive assessment of the role which lease financing plays in capital formation in the United States. The study is based on a newly collected body of statistical and other information which made it possible to describe the pattern and magnitude of lease financing in American industry in recent years.

Economic Incentives for Lease Financing

The acquisition of capital equipment through leasing has expanded substantially in recent years. This is primarily a reflection of the increased appreciation of the economic benefits provided by this source of financing. The tax incentives introduced in the 1950's and 1960's — designed to encourage investment spending — gave a strong boost to leasing. The reason is straightforward: **Leasing lowers the cost of capital to many businesses while providing tax benefits to lessors who bear the risk of ownership**. If a firm needing equipment faces a tax situation which precludes its taking advantage of accelerated depreciation or the investment tax credit, it can lease the equipment from another company which can use the tax benefits. The availability of tax benefits to the leasing company enables the latter to charge rents below the cost to the user of purchasing the equipment.

Beyond tax incentives, however, a number of other economic factors make leasing an attractive financial instrument for many companies. These include the high cost of tying up cash in equipment

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National Economic Policy

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purchases that might be better employed in other uses such as the provision for working capital or to acquire short-term financial assets. Moreover, compared with the use of bank loans to purchase equipment, leasing requires a smaller down payment and typically involves fewer restrictions. Many lease arrangements also include the added value of maintenance and repair services.

Costs of Leasing: Public Policy Perspective

The benefits of leasing (particularly the tax savings) accrue primarily to the lessor and lessee, the principal parties to the transaction. The counterpart of these private tax savings is the loss of tax revenue by the federal government. This loss of tax revenue is roughly equivalent to expenditures of Federal funds, and they are computed and accounted for as "tax expenditures." For instance, in fiscal year 1982, total tax expenditures were calculated at $253.5 billion. Of this amount, $198.4 billion were benefits to individuals, and the remaining $55.1 billion (21.8 percent of the total) were benefits to corporations.

These benefits to business enterprises represent a direct reflection of the express intent of Congress to provide benefits and incentives — through the Tax Code — for companies to undertake certain types of economic activity. The most important of

"The loss of tax revenue is commonly known as a 'tax expenditure.' Benefits, such as leasing, to corporations amounted to $55 billion in 1982. Benefits to individuals amounted to $198 billion in the same year."

these specific objectives is the stimulation of investment in new plants and equipment. The tax benefits derived from leasing have been a major source of support for this new investment.

For instance, in fiscal year 1982, tax benefits associated with all lease financing are estimated at $6.7 billion. This figure represented 31.4 percent of total tax benefits generated by capital expenditures. The leasing-related benefits were divided into those associated with traditional guideline leasing ($4.0 billion) and "safe harbor" leasing

($ .7 billion). Thus, despite the large but transitory impact of "safe harbor" leasing, the traditionally used guideline leasing accounted for 60 percent of the tax benefits derived from leasing. Consequently, lease financing clearly has an important — and growing — role in the promotion of new capital investment. Its share of tax benefits appears to be an accurate reflection of the contributions this type of financing makes to total investment expenditures.

Lease Financing of Business Investment

Lease financing has expanded to the point where it is the most important single source of funds to support business expenditures for capital equipment. For example, as shown in Table 1, in 1982, spending on business fixed investment amounted to $347.6 billion. This total was divided into outlays for structures ($141.4 billion) and producers' durable equipment ($206.2 billion). In the same year, equipment leasing is estimated at $57.6 billion. At this level, lease financing was equal to 16.6 percent of total business fixed investment. It also represented 27.9 percent of outlays for producers' durable equipment.

Moreover, during the last few years, leasing has risen faster than total capital expenditures. Lease financing as a proportion of the latter climbed from 14.1 percent in 1980 to 16.1 percent in 1981, and to 16.6 percent last year. During 1983, the fraction is projected to rise further to 18.7 percent.

These estimates suggest that leasing is a more important source of funds to meet business capital requirements than either new equity issues, corporate bonds, commercial bank loans, or commercial mortgages. Leasing is at least five times as important as new equities or commercial mortgages and nearly 1½ times as important as corporate bonds and commercial bank loans.

Lease Financing: Industry Profile

While leasing finances about one-sixth of business fixed investment across American industry taken as a whole, the proportion is much higher for a number of important types of equipment. The broad pattern and extent of reliance on leasing can be seen in Table 2, which shows capital expenditures and lease financing of selected types of equipment in 1982.

Capital expenditures for aircraft are the most heavily dependent on lease financing. In 1982,

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such expenditures came to $4.0 billion, and leasing provided $1.8 billion (45.0 percent) of this amount. Second in line were railroads, where $700 million in leasing accounted for 35.0 percent of capital outlays. Close behind were motor vehicles. Businesses spent $30.1 billion for this type of equipment and $9.3 billion (30.9 percent) was provided by leasing. In the case of shipping, nearly one-quarter (22.6 percent) of the value of newly produced non-military vehicles was covered by leasing.

Capital outlays for computers amounted to $34.0 billion in 1982. Leasing supplied $5.0 billion (14.7 percent) of the required financing. Spending on agricultural equipment came to $13.3 billion. However, lease financing has not made much headway in this sector, and it accounted for only 5.3 percent.

Leasing, Investment and Employment

Leasing makes a major contribution to the creation of new jobs in the American economy. This contribution arises primarily through the support of business spending on new plants and equipment. Such outlays stimulate the demand for capital goods and for a variety of related products and services. As output rises to meet these demands, labor requirements increase, and new jobs are created.

"More than 30 percent of the $30 billion spent for motor vehicles in 1982 was financed by leasing — $9.3 billion dollars."

For example, lease financing of computers and equipment is estimated to have stimulated the creation of about 177,000 new jobs in 1981. Among the eight types of equipment studied, the number of new jobs ranged from just over 40,000 in construction machinery and equipment to more than 308,000 in transportation equipment.

Concluding Observations

The results of this study lead to several important conclusions: traditional guideline leasing does derive a part of its appeal to investors from the Federal income tax benefits associated with the capital expenditures financed under this type of arrangement. However, those benefits are an integral part of the series of tax incentives which the Federal Government has provided to help achieve a variety of worthwhile public purposes. And among the latter, the stimulation of investment and the creation of new jobs have been given the highest priority on the agenda of national economic policy. ■

Table 1
Financing Business Investment, 1980-1983
(Amounts in Billions of Dollars)

Category	1980	1981	1982	1983 F
Business Fixed Investment	309.2	346.1	347.6	327.9
Structures	110.6	129.7	141.4	130.2
Producers' Durable Equipment	198.6	216.4	206.2	197.7
Selected Sources of Funds				
Equipment Leasing	43.5	55.5	57.6	61.2
Corporate Equities	12.9	-11.5	1.7	8.5
Corporate Bonds	32.9	35.6	42.0	42.4
Commercial Mortgages	20.7	-1.1	-0.8	6.9
Commercial Bank Loans	29.3	42.8	38.7	-7.4
Sources of Funds as a Percent of Business Fixed Investment				
Equipment Leasing	14.1	16.1	16.6	18.7
Corporate Equities	4.2	-3.3	0.5	2.6
Corporate Bonds	10.6	10.3	12.1	12.9
Commercial Mortgages	6.7	-0.3	-0.2	2.1
Commercial Bank Loans	9.5	12.4	11.1	-2.2

F = Forecast

Source: Compiled and calculated by Brimmer & Company. Data on business fixed investment from U.S. Department of Commerce, Bureau of Economic Analysis. Data on sources of funds from the Board of Governors of the Federal Reserve System. Data on equipment leasing calculated by Brimmer & Company, based on the American Association of Equipment Lessors, *Annual Survey*, 1980, 1981, 1982.

Table 2
Capital Expenditures and Lease Financing of Selected Types of Equipment, 1982
(Amounts in Billions of Dollars)

Category	Capital Expenditures	Lease Financing	
		Amount	Percent of Capital Expenditures
Computers	34.0	5.0	14.7
Railroads — Class I	2.0	0.7	35.0
Motor Vehicles	30.1	9.3	30.9
Aircraft[1]	40.0	1.8	45.0
Shipping[2]	3.1	0.7	22.6
Agricultural Equipment[3]	13.3	0.7	5.3

[1] Capital leases plus tax benefit transfers.
[2] Capital expenditures consist of the value of newly produced non-military vessels.
[3] Farm gross capital expenditures ($12.6 billion) plus new leases of equipment ($0.7 billion), 1981.

Source: Estimates by Brimmer & Company